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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B03
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Date:
October 29, 2015

LEGEND

X =

State =

Date1 =

Date2 =

Date3 =

Date4 =

Date5 =

Date6 =

Date7 =

Dear :

This responds to a letter dated July 30, 2015, and subsequent correspondence, submitted on behalf of X by X's authorized representative, requesting a ruling under §1361 of the Internal Revenue Code ("Code").

The information submitted states that X was incorporated under the laws of State on Date1. X elected to be an S corporation effective Date2. Pursuant to the laws of State, all shareholders have equal rights to distributions and liquidation proceeds, unless modified by the articles of incorporation. X has represented that neither X's articles of incorporation and bylaws nor any other binding agreements modify these rights.

According to the submission, X has filed various state income tax returns, including State, and paid the required shareholder level composite state income tax or the state income tax withholdings due on those returns since Date3. On a state-by-state basis, these state income tax payments are made by X on behalf of each of X's shareholders who are not residents of the state to which composite state income tax or state income tax withholdings are paid. X's shareholders for whom these income taxes are paid (the "Applicable Shareholders"), varies each year depending on the state involved, the state of residency of each shareholder, and the level of taxable income attributed to each shareholder. X declares and pays cash distributions to its shareholders on an annual basis, and these distributions fall into two separate categories. One category is referred as "personal distributions," and the other category is referred to as "tax distributions." Both categories of distributions are declared and paid on a ratable per share basis. When X calculates the total tax distribution payable annually to its shareholders, X reduces the Applicable Shareholders' tax distribution checks by the amount of state composite and withholding taxes paid by X and credited to the Applicable Shareholders. This is performed specific to each shareholder, based on the shareholder's specific composite tax allocations.

On Date4, X discovered that for tax years ending Date5 through Date6, X inadvertently reduced all of its shareholders' tax distributions ratably by the total amount of state composite and withholding taxes paid on behalf of the Applicable Shareholders. X's federal income tax returns, and related Schedules K-1, reported the state composite and withholding taxes as distributed ratably to each shareholder, rather than distributed specifically to the Applicable Shareholders who benefit from the state composite and withholding taxes paid by X. As a result, the Applicable Shareholders received disproportionate distributions, to the extent state composite and withholding taxes were credited (thereby reducing total cash distributions) to the other shareholders.

On Date7, X made equalizing cash distributions to correct the discrepancies between and among the shareholders resulting from the erroneous tax distributions. After these corrective cash distributions, each shareholder has now received, in aggregate, distributions proportionate to the shareholders' ownership percentages in X, for all years. X represents that it has also implemented policies and procedures to ensure that future state composite and withholding taxes paid by X for the benefit of the Applicable Shareholders will be equalized annually with reciprocal cash distributions to the other shareholders.

Section 1361(a)(1) provides that the term “S corporation” means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(D) provides that, for purposes of subchapter S, the term “small business corporation” means a domestic corporation that is not an ineligible corporation and which does not have, among other things, more than one class of stock.

Section 1.1361-1(l)(1) of the Income Tax Regulations provides, in part, that a corporation that has more than one class of stock does not qualify as a small business corporation. Except as provided in § 1.1361-1(l)(4) (relating to instruments, obligations, or arrangements treated as a second class of stock), a corporation is treated as having only one class of stock if all outstanding shares of stock of the corporation confer identical rights to distribution and liquidation proceeds. Differences in voting stock among shares of stock of a corporation are disregarded in determining whether a corporation has more than one class of stock.

Section 1.1361-1(l)(2)(i) provides, in part, that the determination of whether all outstanding shares of stock confer identical rights to distribution and liquidation proceeds is made based on the corporate charter, articles of incorporation, bylaws, applicable state law, and binding agreements relating to distribution and liquidation proceeds (collectively, the governing provisions). Although a corporation is not treated as having more than one class of stock so long as the governing provisions provide for identical distribution and liquidation rights, any distributions (including actual, constructive, or deemed distributions) that differ in timing or amount are to be given appropriate tax effect in accordance with the facts and circumstances.

Based solely on the facts submitted and the representations made, we conclude that, because X's stock has identical distribution and liquidation rights under its governing provisions, X's disproportionate distributions to some of the shareholders and X's corrective distributions to certain shareholders do not cause X to have more than one class of stock for purposes of § 1361(b)(1)(D). However, such disproportionate and corrective distributions must be given appropriate tax effect. Under these circumstances, we conclude that X's S corporation election did not terminate because of the disproportionate and corrective distributions to the shareholders.

Except as specifically set forth above, we express or imply no opinion concerning the federal income tax consequences of the facts of this case described above under any other provision of the Code and the regulations thereunder. Specifically, we express or imply no opinion regarding whether X otherwise qualifies as a small business corporation under § 1361.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, we are sending copies of this letter to your authorized representatives.

Sincerely,

Bradford R. Poston
Senior Counsel, Branch 3
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes

cc: